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MARKET VISTA

PAKISTAN ECONOMY

IMF: 'The wait is over'

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- **The Government has finally decided to opt for another IMF financing facility, which as per news flows amounts to ~US$6-8bn. Key demands in our view could be i) aggressive interest rate hikes, ii) fiscal discipline, and iii) measures to address external account woes.**
- **The currency parity has further slipped to trade around PkR130-133/US$ in the interbank market where we expect it to settle around these levels as GoP is likely to opt for a "wait and see" strategy initially considering its tough stance against inflationary pressures.**
- **Historically, a minor relief rally occurs at the PSX in the 2/3M run-up to an IMF program before paring gains as challenging conditions begin to bite.**
- **In the near term, we believe profit taking on upward movement should be adopted. Over the longer term, however, we recommend thematic exposure in selected sectors including Banks (interest rates), E&Ps (Currency Deval; Int'l oil price), select Power (Currency Deval.), Technology (Currency Deval.) and Textiles (Currency Deval., GoP package).**

Decision finally taken on an IMF program: The Government has finally decided to opt for another IMF financing facility (the 12th program since late 1980s) to bridge financing gap in the backdrop of sharp drawdown in SBP FX reserves (US$1.4bn in FYTD, despite US$2bn inflow from China). However, the GoP has yet to present a formal 'Letter of Intent" with consent of the IMF before any US$ disbursement are made (in the previous program, the process took ~2 months). As per news flows, Pakistan is likely to take ~US$6-8bn under the IMF financing facility, sufficient to cover the net financing gap of US$8.8bn in FY19.

IMF—Consequences of the entry: Although IMF is likely to push for revamping the foreign financing composition (previous strategy to rely on commercial loans should be restricted), however an entry into an IMF program could open other avenues including associated lending agencies (i.e. WB and ADB). Moreover, any financing facility should immediately focus on stabilization measures and advancing structural reforms in order to address vulnerabilities on the external front. Aggressive interest rate hike, rationalization of utility prices, enhancing tax revenues (possibly initiating from indirect taxation including GST), fiscal discipline (possible cut in non-development expenditure), mobilizing domestic resources through recomposing financing, reforms to enhance country's export receipts, and privatization of SOEs are likely to be the key measures demanded by the IMF.

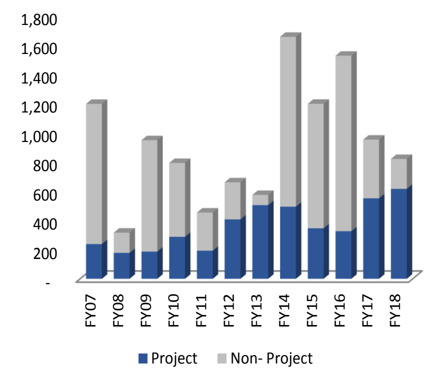
Currency to settle down at these levels: The currency parity has further slipped to PkR130-133/US$ in the interbank market. This came a day after the GoP's decision to enter into another IMF financing facility and in line with IMF's prescription. Despite the mounting pressures on the parity, further aided by volatility in the regional market, we believe the currency is likely to settle around these levels (up to PkR135/US$) in the short run. The GoP is likely to opt for a "wait and see" strategy for the time being considering its tough stance on inflation. In this regard, the commodities have broadly been on the up-cycle where any further currency adjustment will inevitably translate into build-up of price pressures. The GoP is likely to focus more on administrative measures while maintaining contractionary monetary policy to adjust the external imbalance. In our view, the currency could likely crawl up to ~PkR140/US$ in a streamed path rather than abrupt adjustment being made. However, considering pressures from the regional currencies along with elevated CAD in the backdrop of rising trade deficit (up 16%YoY in 2MFY19), possibility of achieving the target by Dec'18 cannot be ruled out, while IMF mandate of trade liberalization and exchange rate flexibility provides no relief.

A 'short term' relief rally in the making; medium run outlook still negative: Pakistan Market plunged 2,189pts during the past two days where announcement to approach the IMF could potentially result in a relief rally, though unsustainable over the medium term. With cyclicals particularly likely to feel the squeeze of currency devaluation and interest rate hikes, we recommend profit taking in the near term while staggered build-up is recommended in Banks (interest rates), E&P (Currency), select Power (Currency), Technology (Currency) and Textiles (Currency and GoP support).

Potential Pak IMF Action Plan

Primary focus:
Monetary tightening and currency adjustment to address external imbalance
More focus on revenue collection both via direct & indirect taxes
Ceiling on net domestic assets (NDA) to limit artificial aggregate demand
Reduce reliance on SBP lending to mobilize domestic resources (i.e. savings)
Floor on net international reserves (NIR) accompanied by ceiling on swap positions
Re-initiation of privatization program (i.e. DISCOs & PSEs)
Unbundling of gas utilities into separate transmission & distribution entities
Trade liberalization through tariff reduction (i.e. custom & regulatory duty)
Further reduction in subsidy on utilities
Mechanism to ensure transparency of bilateral arrangements
Further tightening of anti-money laundering (AML) regulations
Secondary focus:
Regulatory framework of the SBP and SECP to effectively supervise risks in financial system
Reforms in PSEs to stop further bleeding
More autonomy for regulators
Effective framework to ensure debt sustainability (i.e. MTDS)

World Bank non-project disbursements increases during an IMF program (US$bn)



Source: IMF & AKD Research

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Neutral	> 10% to < 16% expected total return
Sell	< 10% expected total return (Rf: 10%)

Old Rating Definitions (Discontinued)

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Accumulate	> 5% to < 20% upside potential
Neutral	< 5% to > -5% potential
Reduce	< -5% to > -20% downside potential
Sell	< -20% downside potential
Not Rated	No investment opinion or recommendation

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